Lembaga Hasil Dalam Negeri Malaysia v Alam Maritim (M) Sdn Bhd

COURT OF APPEAL (PUTRAJAYA) — APPEAL NO W-01–268 OF 2010
ABDUL MALIK ISHAK, SYED AHMAD HELMY AND BALIA YUSOF JJCA
21 MARCH 2012

Revenue Law — Income tax — Deduction — Withholding tax — Payments made to non-resident companies without deduction of withholding tax — Whether applicant was obliged to deduct withholding tax on payment of charter fees to non-resident companies that did not have permanent establishment in Malaysia — Whether article IV of DTA applicable to applicant — Whether provisions of double tax treaties take precedence over Income Tax Act 1967 — Income Tax Act 1967 s 109B

During the period 1998–2004, the applicant had entered into time charter party contracts with non-resident companies, which were operating the business of time charter of ship and crew ('time charter services'). These non-resident companies, which did not have a permanent establishment in Malaysia, were from countries which had entered into agreements for relief against double taxation ('DTA') with Malaysia. The applicant made full payment of the charter fees to the non-resident companies without deduction of withholding tax. On 16 August 2005, the applicant on its own accord applied for a decision from the appellant that its payments to the non-resident companies without deduction of withholding tax was correctly done. The appellant replied that the applicant was obliged to deduct withholding tax on the payment of charter fees pursuant to s 109B of the Income Tax Act 1967 ('the Act'). The applicant filed an application for a judicial review of the appellant's decision. The High Court found in favour of the applicant and hence the present appeal. The appellant submitted that the High Court judge had erred factually and legally and that payment of charter fees to non-resident companies constituted a special class of income under s 4A(iii) of the Act. It was therefore the appellant's contention that the applicant was obliged to deduct withholding tax on these payments. The appellant further submitted that article IV of the DTA was not applicable to the applicant.

Held, dismissing the appeal with costs of RM20,000:

(1) The non-resident companies in the present appeal did not have a permanent establishment in Malaysia. As such, article IV of the DTA, which reinstated the generally accepted principle of double taxation

conventions that an enterprise of one state should not be taxed in another state unless it carried on business in that other state through a permanent establishment, protected the applicant and afforded relief from taxation to the non-resident companies. It was clear that, in accordance with the avoidance of double tax treaties entered between the Government of Malaysia and each of the governments of the countries in which the non-resident companies operated their businesses, the income received by the non-resident companies was taxable as business income in the country where they actually resided. As such, the applicant was not obliged to make deductions of withholding tax in respect of the payments to the non-resident companies (see paras 21–25).

(2) Further the provisions of double tax treaties take precedence over the Act (see para 26).

[Bahasa Malaysia summary

Dalam tempoh 1998 hingga 2004, pemohon memasuki kontrak-kontrak *time charter party* dengan syarikat-syarikat bukan pemastautin, yang menjalankan perniagaan time charter kapal dan anak kapal ('perkhidmatan time charter'). Syarikat-syarikat bukan pemastautin ini, yang mana tidak mempunyai pertubuhan tetap di Malaysia, adalah daripada negeri-negeri yang memasuki perjanjian-perjanjian untuk relief terhadap percukaian dua kali ('DTA') dengan Malaysia. Pemohon membuat pembayaran penuh fi *charter* kepada syarikat-syarikat bukan pemastautin tanpa potongan cukai pegangan. Pada 16 Ogos 2005, pemohon atas usaha dirinya sendiri memohon untuk keputusan daripada perayu bahawa pembayarannya kepada syarikat-syarikat bukan pemastautin tanpa ptongan cukai pegangan adalah dibuat dengan betul. Perayu menjawab bahawa pemohon bertanggungjawab untuk memotong cukai pegangan atas bayaran fi *charter* berikutan s 109B Akta Cukai Pendapatan 1967 ('Akta'). Perayu memfailkan permohonan untuk semakan kehakiman terhadap keputusan perayu. Mahkamah Tinggi memihak kepada pemohon dan maka rayuan ini. Perayu berhujah bahawa hakim Mahkamah Tinggi telah tersilap dari segi fakta dan undang-undang dan bahawa bayaran fi *charter* kepada syarikat-syarikat bukan pemastautin membentuk kelas khas pendapatan di bawah s 4A(iii) Akta. Oleh itu adalah hujahan perayu bahawa pemohon bertanggungjawab untuk memotong cukai pegangan ke atas bayaran-bayaran ini. Perayu selanjutnya berhujah bahawa artikel IV DTA tidak beraplikasi ke atas pemohon.

Diputuskan, menolak rayuan dengan kos RM20,000:

(1) Syarikat-syarikat bukan pemastautin dalam rayuan ini tidak mempunyai pertubuhan tetap di Malaysia. Oleh itu artikel IV DTA, yang mana mengenakan semula prinsip konvensyen cukai berganda yang diterima secara amnya bahawa perusahaan satu negeri tidak patut dikenakan cukai di negeri yang lain kecuali ia menjalankan perniagaan dalam negeri yang

lain melalui pertubuhan tetap, melindungi pemohon dan memberikan relief daripada cukai kepada syarikat-syarikat bukan pemastautin. Adalah jelas bahawa, mengikut pengelakkan perjanjian cukai berganda yang dimasuki antara Kerajaan Malaysia dan setiap kerajaan-kerajaan negeri-negeri dalam mana syarikat-syarikat bukan pemastautin menjalankan perniagaan-perniagaan mereka, pendapatan yang diterima oleh syarikat-syarikat bukan pemastautin boleh dikenakan cukai sebagai pendapatan perniagaan di dalam negeri di mana mereka sebenarnya tinggal. Oleh itu, pemohon tidak bertanggungjawab untuk membuat potongan-potongan cukai pegangan berkaitan bayaran-bayaran kepada syarikat-syarikat bukan pemastautin (lihat perenggan 21–25).

(2) Selanjutnya peruntukan-peruntukan perjanjian cukai berganda mengatasi Akta (lihat perenggan 26).]

Notes

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 2500–2543.

Cases referred to

Director-General of Inland Revenue v Euromedical Industries Ltd [1983] 2 MLJ 57; [1983] CLJ (Rep) 128, FC (refd)

Hock Heng Company Sdn Bhd v Director-General of Inland Revenue [1979] 2 MLJ 51; [1950–1985] MSTC 42, PC (distd)

Legislation referred to

Income Tax Act 1967 ss 4A(iii), 109B

Double Taxation Relief Order 1966 [SG] art XVII para 1

Appeal from: Application for Judicial Review No R1–25–148 of 2007 (High Court, Kuala Lumpur)

Hazlina bt Hussain (Ahmad Khairuddin bin Abdullah with her) (Senior Revenue Counsel, The Legal Department, Inland Revenue Board of Malaysia) for the appellant/Inland Revenue.

R Thilakan (Thilakan & Co) for the applicant/respondent.

Abdul Malik Ishak JCA (delivering the ex tempore judgment of the court):

[1] This is an ex tempore judgment of this court.

[2] This is an appeal by Lembaga Hasil Dalam Negeri Malaysia ('appellant') against the decision of the High Court dated 31 March 2010 which allowed Alam Maritim (M) Sdn Bhd's ('applicant's') application for judicial review with costs of RM3,000.

[3] The applicant is a private company whose main activities are confined to the ownership of vessels and the provision of vessel hire and management. The applicant's operations centred on providing services to Petroliam Nasional Bhd.

[4] Between 1998–2004 ('the said period'), the applicant entered into the 'uniform time charter party for offshore service vessels' contracts which concerned the payment of charter fees for the supply of ships together with crew in the form of services with non-resident companies operating the business of time charter of ship and crew ('time charter services').

[5] Throughout the duration of the said period, these non-resident companies received to account of their business income, payment in full of such charter fees from the applicant. And these non-resident companies *received from the applicant payment in full without withholding tax* for the time charter services rendered.

[6] It must be borne in mind that none of these non-resident companies have a permanent establishment in Malaysia.

[7] And the majority (17 out of 22) of these non-resident companies were from Singapore. The rest were from other countries which had entered into avoidance of double taxation treaties which had been given legal force and effect by orders of the Minister. Essentially these are agreements for relief against double taxation.

[8] On 16 May 2005, the applicant's tax adviser wrote to the appellant and sought for a private ruling that the applicant's payments to the non-resident companies *without deduction of withholding tax* was correctly done.

[9] On 7 July 2005, the appellant rendered its opinion that 'bayaran ini adalah tertakluk kepada cukai pegangan di bawah seksyen 109B Akta Cukai Pendapatan 1967'.

[10] On 1 August 2005, the appellant requested the applicant to confirm 'samada bayaran untuk cukai pegangan' have been paid to the appellant.

[11] On 16 August 2005, the applicant's solicitors submitted an application to the appellant for a decision on the issue of withholding tax.

[12] On 21 May 2007, the appellant by way of a letter gave its reply to the effect that the applicant is obliged to deduct withholding tax on the payments made by the applicant pursuant to s 109B of the Income Tax Act 1967 based on

A the stand taken by the appellant in its letter dated 7 July 2005 that payment of 'charter-fees' to non-resident companies constitute a special class of income under sub-s 4A(iii) of the Income Tax Act 1967.

B **[13]** Aggrieved, the applicant then filed an application before the High Court for a judicial review, and the High Court found in favour of the applicant. Hence, the present appeal by the appellant before this court.

C **[14]** There are common facts among the parties that have propelled itself to the forefront, namely:

(a) that the appellant does not deny the non-resident status of the non-resident companies;

(b) that all the non-resident companies do not have a permanent
D establishment in Malaysia;

(c) that the applicant, on its own accord, applied for a decision from the appellant by letter dated 16 August 2005;

(d) that the payments received by the non-resident companies from the
E applicant were business income; and

(e) that the tax sought by the appellant to be withheld is not income tax of the applicant but is that of the recipient non-resident companies.

F **[15]** In its memorandum of appeal, the appellant avers that the High Court judge erred factually and legally by failing to take into account the legal principles propounded in *Hock Heng Co Sdn Bhd v Director-General of Inland Revenue* [1979] 2 MLJ 51 (PC); [1950–1985] MSTC 42 (PC), and also by failing to take into account that article IV of the agreement between the
G Government of Malaysia and the Government of the Republic of Singapore for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income ('DTA') is not applicable to the applicant.

[16] Put differently, what the appellant is saying is that the applicant is
H obliged to deduct withholding tax on the payments made by the applicant pursuant to s 109B of the Income Tax Act 1967 based on the premise that payment of 'charter fees' to non-resident companies constitute a special class of income under s 4A(iii) of the Income Tax Act 1967 and the agreements between governments for the avoidance of double taxation with respect to taxes
I on income ('DTA') cannot be called upon to afford relief from tax.

[17] We have perused through the judgment of the learned High Court judge with a fine toothcomb and Her Ladyship considered at length the case of *Hock Heng Co Sdn Bhd v Director-General of Inland Revenue*. But *Hock Heng*'s

case is certainly distinguishable on its facts. There, Hock Heng (taxpayer) was 'a company incorporated and resident in Malaysia, had in 1968 an income of $31,415 derived in Malaysia and had suffered a loss in that year of $538,335 on the operations of its branch in Singapore …'. And the Privy Council had to consider the question of whether in computing the taxpayer company's chargeable income for 1968, that loss was to be ignored or brought into account on the basis that the Double Taxation Relief Order 1966 overrode the provisions of the Income Tax Act 1967. The Special Commissioners held that the loss could be set-off against the profits made in Malaysia. This decision was reversed by the Federal Court, affirming the decision of the High Court. The taxpayer appealed. The appeal was allowed and the Privy Council held that under article XVII para 1 of the order, the laws of Malaysia were to continue to govern the taxation of income in Malaysia except where express provision to the contrary was made in the order. Since the order did not contain any provision requiring losses sustained in Singapore to be dealt with differently from the way they were dealt with under the Income Tax Act 1967, the losses were deductible in the computation of income from 'wherever derived'.

[18] Here, the non-resident companies do not have a permanent establishment in Malaysia, and that sets apart the present appeal from the facts of *Hock Heng*'s case.

[19] Taking stock of the situation further, we must categorically say that the legal principles enunciated by Viscount Dilhorne in *Hock Heng*'s case are germane to the occasion at hand and would certainly favour the applicant. When referring to article XVII of the Double Taxation Relief Order 1966 which provided that, 'The laws of each contracting state shall continue to govern the taxation of income in that state except where express provision to the contrary is made in this agreement', Viscount Dilhorne held that, 'The laws of Malaysia are to continue to govern the taxation of income in that state except where express provision to the contrary is made in the agreement. Express provision is made for the exemption of tax in Malaysia of income which suffers tax in Singapore…'

[20] Now, even the dissenting judgment of Lord Russell of Killowen in *Hock Heng*'s case recognised that, 'Malaysian tax was not to be imposed on profits of the Singapore establishment at all. Profits of the Singapore establishment were to be wholly irrelevant to Malaysian tax'.

[21] In the context of the present appeal, the appellant concedes that the non-resident Singapore enterprises do not have permanent establishment in Malaysia. That being the case, article IV of the DTA protects the applicant and

affords relief from taxation to these enterprises. In our judgment, the letter dated 21 May 2007 emanating from the appellant was issued in excess of its jurisdiction.

[22] Article IV of the DTA in all its splendour is worded in this way:

> 1(a) The income or profits of a Singapore enterprise shall not be taxable in Malaysia unless the enterprise carries on business in Malaysia through a permanent establishment situated in Malaysia. If the enterprise carries on business as aforesaid, tax may be imposed in Malaysia on the income or profits of the enterprise but only on so much thereof as is derived by that permanent establishment in Malaysia.

[23] It restates the generally accepted principle of double taxation conventions that an enterprise of one state shall not be taxed in the other state unless it carries on business in that other state through a permanent establishment situated therein.

[24] It is crystal clear that in accordance with the avoidance of double-tax treaties entered between the Government of Malaysia and each of the governments of the countries in which the non-resident companies operate their respective businesses, the income received by them are taxable as business income in the country where they actually reside or originate from.

[25] Thus, all payments to account received from the applicant during the said period comprise income or profits of a foreign enterprise with no permanent establishment in Malaysia, which are afforded relief from tax in Malaysia by virtue of these avoidance of double tax treatises.

[26] In our judgment, with the relief from double taxation afforded to these non-resident companies in Malaysia, the applicant is not at all obliged to make deductions of withholding tax in respect of the payments to the said non-resident companies. It must be borne in mind that the provisions of these treaties take precedence over the Income Tax Act 1967 (per Wan Suleiman FJ in *Director-General of Inland Revenue v Euromedical Industries Ltd* [1983] 2 MLJ 57; [1983] CLJ (Rep) 128 (FC)).

[27] For the reasons adumbrated in this ex tempore judgment, we dismiss the appellant's appeal with costs of RM20,000. We affirm the decision of the High Court. The deposit, if any, should rightly go to the applicant respondent.

Appeal dismissed with costs of RM20,000.

Reported by Kohila Nesan